



EdenTree SRI Expert Briefing – April 2014

Amity Funds SRI Company Profile - Tesco

Introduction

The EdenTree range of SRI screened 'Amity' funds hold over 250 different company stocks and debt instruments across their portfolios. As well as having a strong and compelling investment case, each holding must be researched and approved by the SRI team. In this Expert Briefing our SRI team outlines the case for a company that tends to divide opinion: Tesco.

Tesco, the UK's largest food retail group, began life in 1919 as a market stall in London's East End, graduating to its first store a decade later. The name comes from the initials of T E Stockwell, partner in a firm of tea suppliers, and the initials of Tesco founder, Jack Cohen. The company was listed on the London stock exchange in 1947. Tesco was a pioneer of the modern self-service supermarket and originated the 'superstore' idea with the first 40,000 sq. ft. store in Crawley. The company expanded overseas in 1995 when it opened 26 stores in Hungary. Tesco is now the world's third largest retailer by revenues. It is held in both the [Amity International](#) and [Amity UK](#) Funds.

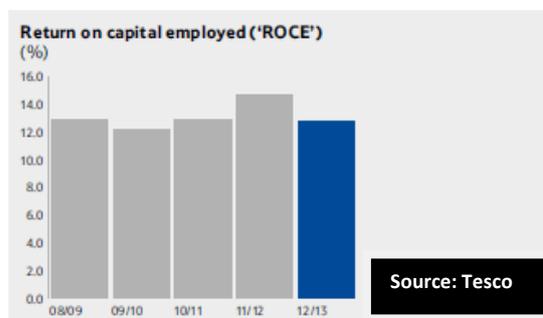


The Business

Tesco's core business remains the UK estate, but it has become a global retailer with a presence in 12 countries, and employing over 530,000 people. In the UK, Tesco operates 3,146 stores in various formats, and 1,507 in Europe (Ireland, Hungary, Slovakia, the Czech Republic, Poland and Turkey). In Asia, Tesco operates 2,131 stores in China, South Korea, Malaysia, and Thailand. The company also wholly owns Tesco Bank with over 6.5m customers, offering a range of simple banking products such as mortgages, credit cards, personal loans and savings. Group revenues in 2012/13 were £72.4bn.

Investment Proposition

Tesco has suffered some negative sentiment of late, withdrawing from the US and Japan, losing market share in the UK to low-cost players such as Aldi and Lidl as well as to J Sainsbury, and issuing a profits warning. Lack of investment in the UK estate has largely been



blamed for some disenchantment among consumers. Despite this, Tesco remains, by a significant margin, the UK's largest and most profitable food retailer with revenues in excess of £72bn per year and Group profit before tax of £2.0bn. It is well diversified, and the number one or two player in five European and three Asian markets: for instance Tesco Poland has 446 stores that drive a turnover of over £2.1bn. In the UK, Tesco dominates with around 30% market share and 75 million shopping trips every week; its nearest rivals (ASDA and J Sainsbury) each have market shares of around 17%. The company, despite some setbacks, remains hugely profitable and cash generative, and delivers a highly respectable 5% yield on a PE of 11 times. TSR (total shareholder return) in 2012/13 was 22.5%, reflecting increased investor and consumer confidence, and compares favourably to a negative TSR of -18.7% in 2011/12. Tesco also enjoyed a healthy Return on Capital Employed in 2012/13 of 12.7%, which is consistent with recent historic averages. The company has historically enjoyed the highest margins in the sector of over 5%, although these are coming under pressure. Globally it has over 43m loyalty scheme members; the largest combined total in the world. As long-term investors we continue to believe there is a strong investment case for holding Tesco given its strong balance sheet, low debt, strong cash generation and progressive dividend policy. Notwithstanding these positives, the continuing structural difficulties in its home market that currently make it a 'recovery' play may make for some short-term volatility.

Sustainability Proposition

Tesco's scale means it can make a difference, and in the key areas of waste management and climate change, Tesco can influence real and progressive change. Whilst its impacts are many, the company has more recently articulated three core ambitions in the corporate responsibility space:

- Creating opportunities for millions of young people around the world
 - helping to break the cycle of 'no job-no experience-no job' by offering 5,000 UK apprenticeships and 500 jobs for the long-term unemployed as part of Tesco's 'Regeneration Partnership Stores'
- Tackling global obesity
 - actively helping customers to live healthier lives, bridging the gap between knowing and doing
- Leading in the reduction of food waste
 - working with suppliers and producers and helping customers to reduce food waste, given on average £680 is wasted annually on discarded food by each family



£290 million

annual savings on energy
and fuel costs since 2006

32.5%

reduction in carbon intensity
of stores and distribution centres
since 2006

These are Tesco's new core commitments, but the company has delivered impressive reductions in greenhouse gasses, water and waste and has spearheaded a successful campaign to become carbon and waste neutral. Since 2006, Tesco has achieved £290m in cost savings by concentrating on reducing energy and fuel costs, whilst also reducing carbon intensity by 32% in stores and distribution centres. A suite of targeted commitments include halving emissions per square foot by 2020 from a 2006 base, and reducing emissions per case of goods delivered by 25% by 2020 compared to 2011. In 2012/13 carbon emissions were reduced by an impressive 33.4% in stores built after 2006 (and by 4.9% in the pre-2006 estate).

The roll-out of LED lighting and remote control heating and lighting systems has driven this performance. Tesco is also measuring its water and waste footprints across operations, the former identifying supply chain water management as a key impact, especially in areas of water stress and shortage.

Tesco is among the largest corporate donors, contributing £78.1m, equivalent to 4% of pre-tax profits to good causes and a further £14m from colleague and customer fund raising.

Sustainable Supply Chain

In the past Tesco has faced criticism for squeezing suppliers. Undoubtedly, a company of Tesco's size and scale entails managing complex supply chains. The food retail sector makes an enormous contribution to supporting and sustaining British farming and more recently the company has made a compelling commitment to 'build better relationships with...farmers, to create a clear and sustainable relationship of equals,' part of which will entail opening up the supply chain to scrutiny so that consumers can 'trace every step from farm to fork'. Long-term relationships and being the partner of choice are key drivers to future sustainability. Examples include working with British pig farmers to manage price volatility risks surrounding animal feed, and establishing a distinct Tesco Sustainable Dairy Group that guarantees a fair price to its 700 dairy farmer members, which has, in turn, afforded investment and growth in the sector. Under the trading responsibly commitment, the company has published sourcing policies on a range of material impacts including soy, palm oil, timber, fair trade, seafood, animal welfare and apparel sourcing in Bangladesh.

Much of this work shows quiet leadership: animal welfare remains an embryonic sustainability concern however Tesco has carried out 687 inspections in 17 countries, of which 360 were unannounced. The company does not support animal testing for cosmetic or household products – a key criterion for the Amity Funds.

Positive Amity Score

The company scores positively across seven of the nine Amity pillars, particularly environment, employee relations and corporate governance. Its community regeneration initiatives also mean Tesco is a good proxy for our urban regeneration pillar.

Business Practices	Community	Governance
		STRONG
Education	Environmental	Healthcare
N/A	STRONG	N/A
Human Rights	Labour Relations	Urban Regeneration
		POSITIVE

Conclusion

Tesco is hard to ignore; it is the UK’s largest and the world’s third largest retailer. Its scale means that it can make a difference in areas that matter: waste, energy efficiency, sourcing sustainably and responsibly. Its scale too means it has key characteristics that make it an interesting investment case: strong balance sheet, low debt, strong cash generation and a progressive dividend policy. Retailers are facing challenging times from online to low-cost competitors. Nevertheless, we continue to believe Tesco merits attention as an investment and sustainability play.

The EdenTree SRI Team

We have a specialist in-house Socially Responsible Investment (SRI) team who carry out thematic and stock-specific research to identify ethically responsible investment ideas for our range of [Amity Funds](#). Headed up by our Senior SRI specialists Ketan Patel, CFA, and Neville White, the team is also responsible for creating an on-going dialogue with companies, allowing us to engage on a wide variety of ethical and socially responsible investment concerns. For investors, it’s an added layer of assurance that client money is being invested in companies that are operating in a responsible and sustainable way. Our ethical and responsible investment process is overseen by an independent [Amity Panel](#) that meets three times a year, and comprises industry and business experts appointed for their knowledge and professional insight.



EdenTree - Ethical Investment Specialist



Since launching the [Amity UK Fund](#) in 1988, EdenTree has taken a leadership role in managing ethical investments through our research, engagement and strong fund performance. Consequently, we were delighted to receive the Moneyfacts Award for Best Ethical Investment Provider 2013. This is the fifth consecutive year we have won this award; we were particularly pleased to win as it is voted for by the IFA community. In 2013, the Amity UK Fund was rated ‘Highly Commended’ in the Investment Week Climate Change and Ethical Investment Awards. We were also awarded Money Observer Best Ethical-SRI Bond Fund for the [Amity Sterling Bond Fund](#). Today we offer four SRI funds under our Amity banner, covering the major markets and investment classes.

Further information

For further information on EdenTree’s SRI range of Amity Funds please contact your EdenTree Business Development Manager, visit www.edentreeim.com or call our IFA support team on 0800 011 3821.

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